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BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION AND PROCUREMENT
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

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Mr. Chairman, Mr. Ranking Member, and Members of the Subcommittee – I appreciate the opportunity to address you today to describe the progress the Department of Energy is making in overcoming the financial management challenges that caused us to lose our unqualified audit opinion on the Fiscal Year (FY) 2005 and 2006 financial statements. The Department of Energy has a long history of strong financial management. We are working hard to restore our financial management credibility, and we expect this progress to be reflected in the audit of the FY 2007 consolidated financial statements.

I understand that the Committee is interested in the events and conditions surrounding our FY 2006 audit opinion, but I would not be forthright if I did not disclose the conditions that occurred in FY 2005 that led to our FY 2006 audit opinion. The Department received unqualified audit opinions on its consolidated financial statements for six consecutive years from FY 1999 to FY 2004. However, in FY 2005, the Department implemented two initiatives to achieve long-term benefits that profoundly altered the accounting operating environment in the Department. First, at the beginning of FY 2005, the Department consolidated and centralized its financial services operations to gain efficiencies that were identified through a competitive sourcing study that was won by the in-house team. Second, six months later, we changed most of the Department's accounting processes and deployed a non-customized, Federally-certified, commercial off-the-shelf core financial system. In hindsight, the Department might have been better served by implementing these business transformations sequentially. Concurrent implementation presented short-term management challenges, which prevented the Department from producing timely, auditable FY 2005 financial statements and, consequently, our auditors reported a material weakness in internal control related to financial control and reporting, and issued a disclaimer of opinion (i.e., was unable to provide an opinion) on the FY 2005 financial statements.

The disclaimer of opinion on the FY 2005 financial statements led to the development and implementation of a two-year plan for regaining our unqualified audit opinion. A two-year recovery was required since the disclaimer on the ending FY 2005 balances automatically became a disclaimer on the FY 2006 opening balances. Once the Department receives an unqualified opinion on its balance sheet, it will then have an audit-acceptable opening balance on which to base the opinion on the rest of the financial statements. The earliest this can be achieved is on the Department's FY 2007 financial statements.

FY 2005 Remediation Efforts

The Department's senior leadership took the audit outcome very seriously. The Secretary and Deputy Secretary made it clear that the financial problems we experienced were not solely owned by the Office of the Chief Financial Officer, but rather by every element of the Department, and called on the entire leadership team to engage in solving this serious management challenge. In October of 2005, the Chief Financial Officer established a multi-disciplinary team of financial professionals from both Headquarters and the field to identify the root causes of the Department's financial management challenges and to recommend a path forward. The team began its analysis before the Department received the official FY 2005 audit results and, once received, incorporated the results into their analysis. In December of 2005, the team presented its results to the Deputy Secretary, and he accepted the recommendations without modification. In short, 30 issues were identified in three broad categories: 1) people; 2) processes; and 3) technology issues. It was originally assumed that the root cause was the new accounting system, but the analysis revealed most problems were related to people and processes. The overriding recommendations centered on the need for: clarifying financial management roles and responsibilities; re-defining business processes to reflect the Department's new accounting environment; and gaining a greater understanding of the new system's functionality and reporting capabilities. The team also presented the remediation plan to all senior financial leaders and program resource managers in December 2005. A senior manager was assigned ownership for each area, and work began immediately on the 22 high and medium priority issues.

Office of Inspector General Review of Remediation Activities

From February to June 2006, the Office of Inspector General (OIG) initiated a series of reviews to determine whether the Department's planned and completed corrective actions adequately addressed critical control weaknesses in the financial management and reporting process. As part of that effort, the OIG issued four progress reports on the Department's efforts. Each report commented on observed progress and included recommended actions such as accelerated reconciliations and a re-prioritization of remediation activities. While the reviews were substantially less in scope than the financial statement audit, they provided a clear indication for the Department's senior leadership of the progress on our remediation efforts.

The FY 2006 Audit Result

FY 2006 was the first full year of operations with the Department's new core financial system, and the many issues and challenges contained in the remediation plan commanded considerable attention and staff resources throughout the year. While the financial statement auditors were only engaged to issue an opinion on our FY 2006 consolidated balance sheet because of opening balance issues relating to FY 2005, the audit covered the entire scope of the Department's financial operations. The FY 2006 audit opinion on the balance sheet was upgraded from a disclaimer of opinion to a qualified opinion, which is a major step closer to an unqualified opinion. The qualification in FY 2006 was due to concerns relating to the Department's accounting and reporting for obligations and undelivered orders, and this issue was identified as a material weakness. The Inspector General, in a memorandum accompanying the auditors' report, did note that the Department, "made substantial progress in correcting a number of financial controls and reporting weaknesses that led to the disclaimer of an audit opinion on the FY 2005 financial statements."

FY 2006 Remediation Activities

The Department's senior leadership continued to provide strong direction and support for addressing the issues preventing the Department from regaining its unqualified audit opinion.

Biweekly briefings were presented to the entire Departmental senior leadership team on the status of our remediation efforts. A task force was established, and a plan was developed and executed to correct the problems identified with obligations and undelivered orders. The planned actions included correcting abnormal balances, clarifying procedures, and performing a comprehensive reconciliation of about 1,200 contracts comprising over 95 percent of our September 30, 2006 undelivered orders balance. With tremendous support from across the Department, this phase of the remediation is now complete. Contractual arrangements have been made to have the auditors re-test the ending FY 2006 balances, and the auditors' re-test is underway. We are optimistic that this audit work will confirm the propriety of our undelivered orders balance and clear the qualification on the FY 2006 ending balances, setting the stage for regaining our unqualified audit opinion on the full set of consolidated financial statements this fiscal year.

Summary

Implementing a core financial system, establishing and operating under a new chart of accounts, and reorganizing financial services operations are never easy undertakings. Doing them in the same fiscal year created a major financial management challenge for the Department. Decisions to implement these initiatives were made with the best of intentions. While we did not fully anticipate all the challenges that we encountered, the Department's response to these challenges has been aggressive, effective, and has positioned us for improved financial management. We look forward to regaining our unqualified audit opinion this fiscal year and restoring financial management credibility with our customers and stakeholders.

This concludes my prepared statement, and I will be pleased to respond to any questions you or the Subcommittee may have.